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No. 44

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1963

UNITED STATES OF AMERICA, *Petitioner*

v.

AARON ZACKS and FLORENCE ZACKS, *Respondents*

On Writ of Certiorari to the United States Court of Claims

BRIEF FOR RESPONDENTS

SCOTT P. CRAMPTON

STANLEY WORTH

Korner, Doyle, Worth & Crampton

404 Transportation Building

Washington 6, D. C.

Attorneys for Respondents

ROBERT F. CONRAD

Watson, Cole, Grindle & Watson

815-15th Street, N. W.

Washington 5, D. C.

Of Counsel

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STATUTES:**Internal Revenue Code of 1939:**

Sec. 117(q)2, 4, 7, 8, 11

Sec. 322(b)(1)2, 11

Internal Revenue Code of 1954:

Sec. 7422(a)2, 12

MISCELLANEOUS:

12 ALR 2d 4309

54 C. J. S. Limitations of Actions, § 3239

Gitlin and Woodward, "Tax Aspects of Patents,
Copyrights & Trademarks," Practicing Law In-
stitute, 19606

Mertens, Law of Federal Income Taxation, § 22.1336

Sutherland, Statutory Construction, 2d ed. 1943,
§§ 5201 and 52049

United States Constitution, Article I, Section 8,

Clause 88

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OPINION BELOW

The opinion of the Court of Claims (R. 11-14) is reported at 280 F. 2d 829.

JURISDICTION

The petition for certiorari was granted on January 14, 1963 (R. 31; 371 U.S. 961). The jurisdiction of this Court is invoked under the provisions of 28 U.S.C. 1255(1).

QUESTION PRESENTED

The question as stated in the petition for certiorari fairly presents the issue. The language used was as follows (p. 2):

Whether a retroactive tax relief measure applicable to years otherwise barred by the statute of limitations must be deemed by implication to reopen the limitations period even though it does not expressly so provide.

In its recent brief the Government has restated the question by attempting to qualify the statute as a "clarifying or modifying" amendment. As will be shown herein, respondents do not believe this characterization is justified, and they question whether the recent restatement is not a change of substance in disregard of Rule 40.1(d)(2) of the Rules of this Court.

STATUTES INVOLVED

The pertinent statutes are § 117(q) of the Internal Revenue Code of 1939 as added by § 1 of the Act of June 29, 1956; § 322(b)(1) of the Internal Revenue Code of 1939; and § 7422(a) of the Internal Revenue Code of 1954. The relevant provisions of these statutes are set forth in the Appendix, *infra*, pp. 11-12.

STATEMENT

The respondent Florence Zacks is an inventor and at the time of trial was the holder of about fourteen patents (R. 23-26, 29). Substantially all of her income was derived from royalties paid to her for the use of her inventions (R. 1-2, 4-5, 17). The Court of Claims made no finding as to whether she was a professional or an amateur inventor (R. 11-14). The

brief for the Government has assumed that she was an amateur. Such an assumption is believed to be unwarranted. Under all of the decided cases and rulings in effect prior to 1956, she would have been considered to have been a professional inventor and to have been engaged in the business of selling her inventions.¹

In 1952, Mrs. Zacks received royalties amounting to approximately \$37,000 which she reported in her Federal income tax return as ordinary income (R. 2, 5, 17). This was in accordance with the then existing rulings of the Internal Revenue Service (R. 2, 5, 12). The statute of limitations on filing a claim for refund of taxes paid for 1952 expired on April 15, 1956 (R. 6; Govt. Br. 2).

After the expiration of the statutory period for filing a refund claim for 1952, Congress amended the 1939 Code expressly granting to professional inventors the right to accord long-term capital gain treatment to all qualifying transfers of patent rights, a right which, admittedly, they did not have prior to the amending legislation (R. 2, 5; Govt. Br. 10). The statute also set at rest the Court holdings to the effect that amateur inventors had a similar right, a right which the Commissioner of Internal Revenue had generally denied administratively prior to its enactment (R. 13; Govt. Br. 9-10). On June 23, 1958, within two years after said enactment, respondents filed the usual claim for refund asserting that under the provisions of § 117(q) they were entitled to report as long-term capital gains, rather than as ordinary income, the \$37,000 royalties which they had received in 1952 (R. 2, 5-6).

¹ This legal principle is discussed in connection with the argument, *infra*, pp. 5-6.

When the Commissioner of Internal Revenue failed to act on the claim for refund within six months (R. 3, 5), respondents brought suit in the Court of Claims (R. 1). They were met with the defense that their cause of action was barred because the claim for refund had not been filed within three years of the filing of the return or within two years of the payment of the tax (R. 6). In order to test this defense, the respondents filed a motion to strike it (R. 8) which was granted by the Court of Claims (R. 11-14).

Following a trial on the merits (R. 19), the parties agreed upon a judgment for the taxpayers in the amount of \$4,624.09, reserving to the United States the right to seek a review of the holding on the statute of limitations question (R. 17-18).

SUMMARY OF ARGUMENT

The petitioner misconstrued the effect of the 1956 amendment in contending that it merely put "to rest a live controversy" (Govt. Br. 7). Insofar as professional inventors were concerned, no live controversy was extant, and they had no valid basis for filing a claim for refund until the 1956 amendment.

At the time § 117(q) was enacted, the normal statute of limitations had already expired as to 1952. In this posture of the case, the Act of Congress was an "idle gesture," as the Court below suggested, if the creation of new rights by the 1956 statute was already nullified by the previous passage of time.

The action or lack of action with regard to the statute of limitations taken by Congress in 47 dissimilar enactments, in no way indicates Congressional intent as to § 117(q). It is agreed that in making the 1956

retroactive change effective for 1952, Congress intended that the professional inventors would derive some new benefit from the legislation (Govt. Br. 45).

In the event that resort is had to rules of statutory construction, then § 117(q) should be held to start anew the running of the statute of limitations in order to give effect to both statutes, to permit a special and later statute to prevail over a general and earlier one, and to give a relief statute the liberal construction to which it is entitled.

ARGUMENT

I. Insofar as Mrs. Zacks is Concerned, the 1956 Legislation Specifically Created New Rights

The Government begins its brief by pointing out in some detail the vacillating administrative treatment given to amateur inventors prior to the legislation here involved (Govt. Br. 9-11; cf. R. 12-13). The Government fails to point out that the "conflict" between the courts and the Commissioner was confined to royalties paid to amateur inventors. The amending statute, it should be emphasized, did much more than rectify the inconsistent administrative positions. As the Government admits (Br. 10-11, fns. 2, 3, Br. 45), the statute changed the law in two respects: (1) it gave professional inventors, for the first time, the right to treat qualifying patent royalties as long-term capital gain; and (2) it allowed all inventors to treat their qualifying patent royalties as long-term capital gain even though the property had not been held for the customary six months.

The Government presents its case, however, on the theory that the 1956 amendment was designed to "put at rest" litigation that was already pending; and it

was clearly in this context that the Fifth and Sixth Circuits decided the *Tobin* and *Dempster* cases cited by the Government (Govt. Br. 12, fn. 5 and Br. 41 and 44).

The taxpayers submit that this theory cannot be stretched to cover their case where it seems readily apparent that prior to 1956, they had no justifiable cause of action. Most of the pre-1956 cases turn solely on the question of whether the particular taxpayer was or was not a professional inventor. If the taxpayer owned more than four patents, he was generally held to be in the business of inventing,² and respondents have found no case in which anyone with as many as fourteen patents was held to be an amateur.

It accordingly follows that Mrs. Zacks as a professional inventor did not sleep on any rights which were available to her prior to 1956. Before § 117(q) was enacted, she had no right to capital gain treatment of her royalties. It was the enactment of that section of the Code which, for the first time, gave her that right. Respondents filed the necessary claim for refund within two years of the enactment of the new legislation (R. 2, 5-6). The Court of Claims was accordingly correct in holding that the creation of new substantive rights should not be construed to be an "idle gesture" when to do so would attribute to Congress the concurrent granting and denial of a right by legislation which was admittedly remedial.

² In *Lorens v. United States*, 296 F. 2d 746, 749 (Ct. Cl., 1961), it was admitted that the taxpayer was a professional inventor (Cf. Govt. Br. 44, fn. 30). The cases and articles are collected at 3B Mertens, Law of Federal Income Taxation, § 22.133, and particularly at footnotes 90, 91, and 97, and at Gitlin and Woodward, "Tax Aspects of Patents, Copyrights & Trademarks," Practising Law Institute, 1960.

II. The Action of Congress in 47 Distiller Statutes Does Not Create Any Pattern Which Is Helpful in the Instant Proceeding

On pages 15 to 32 of its brief, the Government has set forth a number of instances in which the Congress has seen fit to change existing legislation and either shorten or enlarge periods for filing claims or, in other instances as in the case at bar, has been silent.

As a matter of statutory construction, legislation should be construed so as to have both purpose and effect. The role of statutory construction is not to create doubts. As was said in *United States v. Rice*, 327 U.S. 742, 752-753 (1946):

Statutory language and objective, thus appearing with reasonable clarity, are not to be overcome by resort to a mechanical rule of construction, whose function is not to create doubts but to resolve them when the real issue or statutory purpose is otherwise obscure.

The rule to be followed here was enunciated in *United States v. Borden Co.*, 308 U.S. 188, 198 (1939), as follows:

It is a cardinal principle of construction that repeals by implication are not favored. *When there are two acts upon the same subject, the rule is to give effect to both if possible.* (Italics supplied.)

The holding of the Court of Claims in the case at bar observes this rule by giving effect to § 117(q) when claims have been filed after its enactment and within the general limitations period following the enactment. The Third Circuit, while denying relief in *Smith v. United States*, 304 F. 2d 267, certiorari pending (No.

14, 1963 Term), tacitly implies that had the claim been filed within two years after enactment it would have been timely (Govt. Br. 13, fn. 10).

What action should be taken by this Court in connection with various other statutes is a proper subject for decision when those cases and their particular facts are presented to the Court.

III. The Statutes of Limitation Should Not Be Construed to Bar the Present Cause of Action Under Well Established Rules of Statutory Construction

The fundamental purpose of the statute of limitations is to put at rest stale controversies where one of the parties has slept on his rights. This basic purpose is certainly not accomplished where the taxpayer had no rights until Congress changed the law so as to give these rights.

If general statutory construction rules should be considered, then the following holdings are applicable. First, statutes are to be construed so as to give effect to all of them where it is practical to do so.³ The holding below accomplishes this result by treating § 117(q) as creating a new cause of action to which the limitations period begins anew to run. Second, § 117(q) is clearly a remedial provision and should be liberally construed so as to give the relief it was intended to provide.⁴ Third, § 117(q) being specific legislation,

³ *United States v. Menasche*, 348 U. S. 528, 538-539 (1955); *Markham v. Cabell*, 326 U. S. 404, 411 (1945).

⁴ *Bonwit Teller & Co. v. United States*, 283 U. S. 258, 263 (1931); *Wing v. Commissioner*, 8 Cir., 278 F. 2d 656, 661 (1960; considering § 117(q)); *Bannister v. United States*, 5 Cir., 262 F. 2d 175, 178 (1958); United States Constitution, Article I, Section 8, Clause 8.

must prevail over the general legislation.⁵ Fourth, the 1956 subsequent legislation should prevail over the earlier statutes.⁶ Fifth, the statute of limitations should not be applied where one party has induced another to forego procedures which would avoid the bar of the statute.⁷

Thus in equity and good conscience the nation's tax collector should not be permitted to tell taxpayers formally that they must report patent royalties as ordinary income (R. 13) and then defend actions such as this on the premise that the taxpayers should not have believed him. Such a position, if allowed, necessarily will breed litigation because taxpayers are being told that they must follow administrative holdings at their own risk and jeopardy. For years the Government has been endeavoring to build up the effectiveness and validity of administrative rulings. It is surprising that in this case it is now suggesting that taxpayers should follow such rulings only at their peril and that to save themselves from the statute of limitations they should file claims or lawsuits regardless of the chances of success.

While petitioner suggests that it is perplexed over the proper statute of limitations to apply (Govt. Br. 40), such a problem is not a part of this case. If the enactment is considered to be effective after the statute

⁵ *Missouri v. Ross*, 299 U. S. 72, 76 (1936); *Haskins & Sells v. United States*, 91 Ct. Cl. 35; 40 (1940); 2 Sutherland, *Statutory Construction* (2d ed., 1943), § 5204.

⁶ *Oates v. First National Bank*, 100 U. S. 239, 244 (1879); 2 Sutherland, *op. cit.*, § 5201 at fn. 8; and 12 ALR 2d 430.

⁷ The classic example in this field is the payment of interest on a note which the courts have generally held begins anew the running of the statute. 54 C.J.S. *Limitations of Actions* § 323.

of limitations has run, then it seems apparent that the enactment has created "a constructive payment" or overpayment of the tax as of the date the Act was approved. The general limitations and claims for refund provisions would thereafter be applied to this constructive payment date.⁸

CONCLUSION

The taxpayers prior to 1956 had no right to treat their patent royalties as long-term capital gain. They were given this right by Congress in § 117(q) and it should be recognized by the Courts where, as here, taxpayers have acted within two years of the new enactment. The judgment of the Court of Claims should be affirmed.

Respectfully submitted,

SCOTT P. CRAMPTON

STANLEY WORTH

Korner, Doyle, Worth & Crampton
404 Transportation Building
Washington 6, D. C.
Attorneys for Respondents

ROBERT F. CONRAD

Watson, Cole, Grindle & Watson
815-15th Street, N. W.
Washington 5, D. C.

Of Counsel

⁸ This has been the holding of the Court below (Govt. Br. 12-13). Cf. *Smith v. United States*, 3 Cir., 304 F. 2d 267, 269 (1962), certiorari pending (No. 14, 1963 Term). In opposing certiorari in the *Smith* case the Government indicated that the correct period of limitations to be applied "is not a matter of basic principle warranting review by this Court in the absence of a conflict." (Govt.'s Br. in *Smith v. United States*, *supra*, page 8).

APPENDIX**INTERNAL REVENUE CODE OF 1939:****SEC. 117. CAPITAL GAINS AND LOSSES.**

(q) [as added by Sec. 1 of the Act of June 29, 1956, c. 464, 70 Stat. 404]. **TRANSFER OF PATENT RIGHTS.**—

(1) **GENERAL RULE.**—A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 6 months, regardless of whether or not payments in consideration of such transfer are—

(A) payable periodically over a period generally coterminous with the transferee's use of the patent, or

(B) contingent on the productivity, use, or disposition of the property transferred.

(4) **APPLICABILITY.**—This subsection shall apply with respect to any amount received, or payment made, pursuant to a transfer described in paragraph (1) in any taxable year beginning after May 31, 1950, regardless of the taxable year in which such transfer occurred.

(26 U.S.C., Supp. V, Appendix, 117.)

SEC. 322. REFUNDS AND CREDITS.

(b) **LIMITATION ON ALLOWANCE**—

(1) **PERIOD OF LIMITATION.**—Unless a claim for credit or refund is filed by the taxpayer within three years

from the time the return was filed by the taxpayer or within two years from the time the tax was paid, no credit or refund shall be allowed or made after the expiration of whichever of such periods expires the later. If no return is filed by the taxpayer, then no credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

* * * * *

(26 U.S.C. 1952 ed., Sec. 322.)

INTERNAL REVENUE CODE OF 1954:

SEC. 7422 CIVIL ACTIONS FOR REFUND.

(a) NO SUIT PRIOR TO FILING CLAIM FOR REFUND.—

No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary or his delegate, according to the provisions of law in that regard, and the regulations of the Secretary or his delegate established in pursuance thereof.

* * * * *

(26 U.S.C. 1958 ed., Sec. 7422.)